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11. (U) Sensitive but unclassified. Not for public Internet.

12. (SBU) SUMMARY: Questions remain about how BTA, Kazakhstan's fourth largest commercial bank which is already in partial default, and its self-exiled former chairman, Mukhtar Ablyazov, managed to wind up in such dire straits. Foreign investors and government officials alike anxiously await the results of a KPMG audit, hoping that it will shed some definitive light on the seemingly bottomless pit that is BTA's balance sheet. The Government of Kazakhstan, which has purchased almost 80 percent of the bank since January, remains hopeful that once the bottom line for BTA has been established, the price will be right for a sale to Sberbank Rossii (the Russian Savings Bank). In the last month, several international banks including Morgan Stanley have tipped BTA into partial default. Other international creditors have closed ranks hoping to prevent the Kazakhstani government, represented by National Welfare Fund Samruk-Kazyna, from abandoning BTA. However, should the ultimate price of saving BTA prove too high, Samruk-Kazyna may resort to "Plan B" -- the dismantling and stripping of BTA assets to protect domestic clients. Although this plan may be the most cost effective measure in the short-term, it would likely impair aspirations for resumed rapid domestic economic development in the coming years. According to one analyst, in the end, Kazakhstan must "ultimately decide for itself whether it wants to be like Turkey or Ecuador." END SUMMARY.
VAGUE ALLEGATIONS AGAINST ABLYAZOV PERSIST

13. (SBU) Questions continue to linger about how BTA, Kazakhstan's fourth-largest commercial bank, and its beleaguered former chairman, Mukhtar Ablyazov, managed to wind up in such dire straits (reftel). Ablyazov has a history of alternating between cooperation with and opposition to Nazarbayev's regime. Most recently, he has been indicted for criminal fraud. Ken Hessel, Senior Analyst for Emerging Markets at ING Investment Management, believes that Ablyazov committed massive fraud over the last two years, during which more than \$10 billion was stolen from the bank. Hessel said that under the scheme, BTA would provide loans to an offshore

entity, which would in turn lend to a second, and then possibly a third offshore entity. Eventually, more investment capital would make its way to BTA, allowing the bank to make more loans. Hessel called Ablyazov and his colleagues "criminals running a ponzi scheme." On the other hand, Larissa Ostrovsky, Managing Director for the CIS at Wells Fargo, does not think things are that simple. "There are many questions, and very few people know the answers. Keep in mind that Ablyazov is now in open conflict with the state and the head of state. In Kazakhstan, there are so many more layers in a case like this than there would be in other countries. This will never be black and white. We have no idea if his actions constitute fraud. We don't know, and we may never know."

ANXIOUS FOR AN AUDIT

14. (SBU) Investors and government officials alike are anxious for the results of a KPMG audit that may shed some light on BTA's balance sheet. (NOTE: According to a March 1 BTA press release, the results of the KPMG audit will be announced in "two months or so." END NOTE.) Medley Global Investors Director Kaan Nazli told Econoff on April 20 that the audit is far easier said than done. According to Nazli, the majority of BTA's loans were special purpose vehicles used to invest in Russian real estate, which were then used to collateralize additional loans. "Had the Russian real estate market not tanked, with a 30-40 percent correction, BTA would have been fine," he said. Describing the audit results as a moving target, Nazli said that as the value of BTA's collateral continues to decrease, so increases the hole in BTA's balance sheet. Hessel told Econoff on April 29 that BTA historically reported to ING that approximately 20 percent of its assets were in Russian real estate. Now, he said, it appears that Russian real estate represented 50-55 percent of BTA's portfolio. "Honestly," said Hessel, "no one knows how big the hole is."

SBERBANK TO THE RESCUE?

15. (SBU) Sberbank has expressed interest in purchasing BTA from National Welfare Fund Samruk-Kazyna, and this may be the bank's best option. Wells Fargo's Ostrovsky said that Samruk-Kazyna would love to see Sberbank buy BTA. Considering the bank's difficulties, she

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said, "I don't think Samruk-Kazyna will be able to convince any western investors to buy in." ING's Hessel believes that once the audit is complete, Samruk-Kazyna will sell BTA to Sberbank, which he said will assume liability for "a couple billion dollars" in exchange for a solid foothold in Kazakhstan's financial sector. According to Hessel, unless BTA's liabilities greatly exceed current estimates of \$10-15 billion, the Russian government, via Sberbank, will happily absorb the short-term cost of such a long-term strategic investment. In contrast, Nazli believes that interaction between BTA and Sberbank will be limited to the management of co-financed assets in Russia. "I do not believe that Sberbank really wants to buy into this mess," said Nazli. Recently in London to conduct BTA debt restructuring talks, Samruk-Kazyna Chairman Kairat Kelimbetov said in a press interview on May 18 that "in my mind, the restructuring will be clarified in June or July. August will be time for Sberbank to make a decision."

MORGAN STANLEY'S CHALLENGE

16. (SBU) After having acquired majority ownership in BTA and Alliance banks, the government of Kazakhstan, through Samruk-Kazyna, has been careful to distance itself from the mounting liabilities of the banks. The search for a strategic investor has also been accompanied by repeated statements from Samruk-Kazyna that any attempt by creditors to accelerate repayment would likely force the Kazakhstani government to abandon its support for the banks (reftel). Much to the dismay of creditors such as Wells Fargo, several international banks including Morgan Stanley have recently challenged this position and intentionally pushed for accelerated repayment. (NOTE: Wells Fargo has combined outstanding facilities with Alliance, the other majority government-owned struggling bank, and BTA of approximately \$50 million. END NOTE.) Moscow-based French Financial Counselor for the CIS Clelia Chevrier told the Charge on May 27 that "it is unclear what game Morgan Stanley is playing," but that it was likely they "had gambled and lost." In reference to recent Morgan Stanley filings, Wells Fargo's Ostrovsky said, "the world is not happy about continued U.S.-inspired volatility." Wells Fargo Vice President Yeliz Lambson echoed this sentiment, and added that Morgan Stanley's recent move to tip BTA into partial default, and thereby cash in on its credit default

swaps, was "shocking" and "threatened to set a precedent in emerging markets, which could put creditors at risk."

¶7. (SBU) In an effort to prevent the government from walking away from the banks, Wells Fargo joined a group of international creditors committed to maintaining dialogue with BTA. The goal is to recoup some of their initial investment by encouraging BTA's management "to distinguish between bond holders and commercial creditors." However, opinions are divided as to whether the government should ultimately honor the contingent liabilities of the private banks in which they now own equity, regardless of the issue of acceleration. According to World Bank country director for Kazakhstan Sergey Shatalov, the government should under no circumstances assume these liabilities. During a May 7 meeting with Energy Officer, Shatalov said that BTA and Alliance owe a combined \$16 billion to foreign creditors, which is "due immediately." (NOTE: The comment was likely made in reference to the possible default of BTA and Alliance, and represents their total estimated foreign liabilities. END NOTE.) However, Shatalov said that despite the partial default of BTA, "I don't see any systemic implications" for Kazakhstan's economic stability. "There is sufficient diversity, controls, and safeguards to mitigate greater damage to the economy," he added.

PLAN B

¶8. (SBU) Shatalov's words may yet resonate deep within the halls of government. During a May 6 meeting with the Charge, Wells Fargo Managing Director Dilek Mutus described concerns that officials at Samruk-Kazyna had shared with her earlier that day. According to Mutus, Kazakhstani officials appreciate the gravity of the situation, and acknowledged that as the banks' largest creditor, the Government of Kazakhstan via Samruk-Kazyna stood to lose as much as \$30 billion in the event of total collapse. However, Wells Fargo's Ostrovsky believes that Samruk-Kazyna has already developed "Plan B" to deal with the worst case scenario of accelerated default. Under

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this scenario, BTA would be dismantled and stripped of its assets, which would then be used to protect its Kazakhstani clients. Ostrovsky said that the government understands that there would be significant fallout as a result, but she believes that in the end, they may have little choice. "They recognize that there will be isolationist consequences. Samruk-Kazyna says, 'We are trying to play by the rules, but the international creditors are not, so we may need to go to plan B.'"

IMF PACKAGE A LAST RESORT

¶9. (SBU) According to Ostrovsky, developments over the next 30-60 days will determine BTA's fate and influence the government's decision whether or not to seek additional resources. The government continues to insist that it has the resources it needs to weather the financial crisis. On April 9, President Nazarbayev announced in Almaty that, "Until now, Kazakhstan has not approached anyone for credit -- not the IMF or the World Bank -- to resolve its issues. And we will continue to work like this." However, during a mid-May regional investment meeting for the European Bank for Reconstruction and Development in London, National Bank Chairman Grigoriy Marchenko did not rule out the possibility of future loans from the IMF, should the country's economic situation deteriorate. "If there is a third stage of the global financial crisis, [a loan from the IMF] cannot be excluded, but it is not part of the agenda now, with current commodity prices," said Marchenko. Following a mission to Kazakhstan in May, the IMF released a report on May 15 suggesting that Kazakhstan will be in for a difficult year. "Our expectation is that the economy will contract by two percent this year, before recovering modestly in 2010," the report read in part. When asked by the Charge if Kazakhstan should take an IMF loan, Wells Fargo Vice President Lambson nodded, saying, "That would be good."

TURKEY OR ECUADOR?

¶10. (SBU) Most financial analysts interviewed believe that the long-term prognosis for Kazakhstan remains healthy. Short-term issues such as the solvency of the largest banks and the government's willingness to honor debts to foreign creditors are most immediate. ING's Hessel believes that officials and analysts alike are concerned that a loss in confidence in BTA could lead to significant investor anxiety at the other major banks, including KazKommertsBank, BankCenterCredit, and Halyk Bank. Hessel also believes the Kazakhstani government is intentionally keeping word of

the seriousness of the banking crisis out of the press. "The government is doing everything it can to keep it quiet to prevent a run on the banks," he said. Representatives from Wells Fargo agreed, but they believe the situation is relatively stable. For them, the greater risk is to the investment climate writ large, particularly if the government walks away from the liabilities of the banks in which it owns equity. Wells Fargo's Mutus said, "These are challenging times, but compared to other countries in the region, Kazakhstan is still doing very well. The long-term prospects are good and the base is large." Despite her disappointment with the government's lack of transparency, Mutus said that she was "very encouraged that Kazakhstani negotiators are travelling to Turkey" to discuss that country's previous experience with financial instability. Kazakhstan, she said, "can't withdraw from the world financial system altogether. In the end, Kazakhstan must think about positioning itself for future growth and ultimately decide for itself to be either a Turkey or an Ecuador."

MILAS